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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

EX PARTE OR LATE FILED

May 19, 1999

Ex Parte

Ms. Magalie R. Salas
Secretary
Federal Communication Commission
Room TW-A325, The Portals
445 Twelfth Street
Washington, D.C. 20554

Re: CC Docket No. 98-137, In the Matter of 1998 Biennial Review—Review of
Depreciation Requirements for Incumbent Local Exchange Carriers

ASD Docket No. 98-91, USTA Petition For Forbearance from Depreciation
Regulation

CC Docket No. 98-177, In the Matter of 1998 Biennial Regulatory Review—
Petition for Section 11 Biennial Review filed by SBC Communications Inc.,
Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell

ASD Docket No. 98-97, In the Matter of United States Telephone Association
Petition for Rulemaking-1998 Biennial Regulatory Review

Dear Ms. Salas:

In accordance with the Commission's rules, please be advised that on May 18, 1999, Mr. Pat Doherty, Ms. Jane Knox, Dr. Bob Harris (of Law & Economics Group or "LECG") and the undersigned, representing SBC Communications Inc. ("SBC") met with the persons listed below in separate meetings to discuss ways to simplify and streamline the manner in which the Commission currently regulates depreciation accounting:

- Mr. Larry Strickling, Chief of the Common Carrier Bureau, Ms. Lisa Zaina, Deputy Bureau Chief and Mr. Bill Bailey, Counsel, Common Carrier Bureau, and Mr. Thom David, Accounting Safeguards Division;
- Mr. Bill Rogerson, Chief Economist, and Mr. Pat DeGraba, Deputy Chief Economist, Office of Plans and Policy; Mr. Thom David, Accounting Safeguards Division; Mr. Don Stockdale, Common Carrier Bureau; Mr. Jay Atkinson and Mr. Doug Sloten of the Competitive Pricing Division; Mr. Howard Schelansky; and
- Mr. Bob Loube, Economist, and Mr. Craig Brown, of the Accounting Policy Division.

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In these meetings, SBC urged the FCC to grant the Petition filed by USTA to forbear from regulating depreciation rates and to allow carriers to employ depreciation rates based upon Generally Accepted Accounting Principles ("GAAP") for Part 32. Alternatively, SBC recommended that the Commission mandate a "Price Cap Carrier Option" whereby a carrier would file a notice with its depreciation rates when its these rates are revised.

Under either of the alternatives noted above, however, SBC urges the Commission to find that it is in the public interest to allow Local Exchange Carriers to use the same depreciation lives and rates for its regulatory reporting purposes as the carrier uses for its external financial reporting. At the same time, the Commission should provide for the use of forward looking economic depreciation lives and rates for financial reporting purposes, and, thus, the use of retirement data would have no role but the rate of technological change and expected decrease in value would be considered. Finally, financial reporting for Part 32 and interstate jurisdictional reporting would be more representative if carriers were allowed to employ lives based upon the concepts supported by GAAP. These principles mandate the determination of lives based upon current information and the most representative view of the expected life of assets. As such, these lives are synonymous with the forward looking concepts of UNE and Universal Service costing.

A summary of the discussion is outlined in the attached. An original and one copy of this letter and the attachments are being submitted. Acknowledgement and date of receipt of this transmittal are requested. A duplicate transmittal letter is attached for this purpose.

Please include this letter in the record of these proceedings in accordance with Section 1.1206(a)(2) of the Commission's Rules.

If you have any questions on this, please do not hesitate to contact Ms. Jeannie Fry at 202-326-8894.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeannie Fry", with a stylized, flowing script.

Attachment

Cc: Mr. Larry Strickling, Chief of the Common Carrier Bureau
Mr. Ken Moran, Chief, Accounting Safeguards Division
Mr. Tim Peterson, Deputy Chief, Accounting Safeguards Division
Mr. Thom David, Accounting Safeguards Division
Mr. Bill Rogerson, Office of Plans and Policy
Mr. Pat DeGraba, Office of Plans and Policy
Mr. Jay Atkinson, Competitive Pricing Division
Ms. Lisa Zaina, Deputy Bureau Chief, Common Carrier Bureau
Mr. Bill Bailey, Counsel, Common Carrier Bureau,
Mr. Don Stockdale, Common Carrier Bureau
Mr. Bob Loube, Economist, Accounting Policy Division
Mr. Craig Brown, Deputy Chief, Accounting Policy Division

CC Docket No. 98-137
Biennial Review of Depreciation Rate Regulation
SBC Communications Inc.

I. Forward looking Depreciation Lives provide the Most Accurate Representation of Economic Costs

- Forward looking depreciation lives take into account actual economic conditions;
- Result in more representative cost estimates for: universal service cost models, interstate rate of return calculations, UNE cost models; and
- Provide a more realistic basis for public policy decisions

II. FCC Prescriptions are not Forward Looking –they are “undeniably Backward Looking”

- Process used by the FCC focuses on past retirement data, which is by definition outdated.
- Periodic prescriptions can not infuse current data on technological change in a real time mode.
- FCC prescribed lives are far longer than comparable companies’ lives e.g. AT&T, TCG etc.
 - See Attachment 1
- Unpredictable technological diffusion and increasing competition creates a need for real time adjustment of lives

III. Use of Forward Looking GAAP Depreciation Lives would aid in addressing Stranded Plant

- GAAP lives are determined in forward looking manner.
- SBC recognized \$7.7 Billion of write-offs in 1995 (GAAP books) as a recognition of underdepreciated plant.
- May 16, 1997 First Report on Access Reform (Para 49) stated an intent to examine compensation for historical costs that have no reasonable opportunity to be recovered as the market place becomes competitive.
- FERC allowed recovery of stranded investment for gas/electric companies transitioning to a competitive environment mandated by the National Energy Policy Act of 1992; FERC does not regulate depreciation rates.

IV. Impact on Interstate/basket Returns from Reserve Amortization or Use of GAAP Lives

- See Attachment A, May 5th SBC ex parte, CC Docket No. 98-137.
- These returns are more realistic and address the significant reserve recovery problem.

V. Impact on UNE Cost Studies and Universal Service from using Forward Looking Depreciation Lives

- See Attachment C, May 5th SBC ex parte, CC Docket No. 98-137
- Most state commissions within SBC franchise areas require use of FCC prescribed lives (remaining life rates based on embedded plant) for UNE cost studies.
- Universal Service models need to use forward looking depreciation lives to provide accurate cost estimates for the universal service fund size and distribution to companies.
 - Current FCC mandate is to utilize prescribed ranges for lives.

VI. Accounting for Part 32 Depreciation differently from GAAP requires investment in people/time; filing studies/updates also requires resources

- SBC spends \$500 K annually when filing studies.
- Two accounting depreciation systems/tax adjustment processes are required.

VII. SBC urges the FCC to allow price cap carriers to utilize lives based on GAAP principles. – Change Lives as information becomes available.

- Carriers are capable of estimating lives (Capital programs, TFI data). Auditors are capable of reviewing estimates and do so in financial audits.
- Price cap plans preclude the need for cost based depreciation regulation.
- Carriers filing low end adjustments utilizing non-prescribed lives can demonstrate reasonableness of lives.
- Depreciation rate changes have no impact on productivity studies.
- State regulatory plans generally do not focus on cost based calculations anymore.
- California PUC has eliminated depreciation reviews and approvals (Oct 8, 1998, p-51) for Pacific. Order concludes that this (use of company determined lives) precludes “new stranded investment” from occurring.

VIII. Implication of Increasing Competition for Depreciation Policy

- ILECs have the incentive to set accurate depreciation rates.
- Setting prices based on unrealistically short depreciation lives would stimulate facilities-based entry and strand otherwise efficient ILEC facilities
- Increasing competition (especially competitors using new technology as a strategy) shortens depreciation lives
- Accelerating competition makes depreciation forecasting harder; frequent changes and updates to forecasts are necessary; prescription is untenable

IX. Local Competition is Accelerating

- In the first quarter 1998, the CLECs reached a key milestone: for the first time they added more business access lines than the ILECs did.¹
- SBC has lost more than 1 million access lines to direct competition (*these lines are high revenue—cream skimming*)
- Competition from new or superior technologies will have a profound impact on depreciation
 - the highest growth area in telecommunications is in the data transmission area (IP networks etc.) which will require massive investment and reconfigurations of ILECs existing networks which are optimized for voice and circuit switching, making many existing investments outdated
 - Cable companies are upgrading their networks to provide voice telephony and, critically for the future, cable modem services—competing with ILEC voice and DSL access lines
 - Fixed wireless CLECs: Winstar, Teligent, ART
 - Indirect Competition is Substantial and Accelerating: Wireless (cellular and PCS), Private networks (VSATs, PBXs)

¹ Joe Hicks, “CLECs Surpass Bells in Net Business Line Additions For First Time,” Salomon Smith Barney, May 6, 1998.

X. If Depreciation Rate Regulation is not eliminated for PC Carriers, the Commission should mandate the Price Cap Carrier Option for those carriers.

- Proposed for ATT in 1992 by the FCC.
- Carrier would simply file its new rates with the Commission when rates are revised.

XI. Conclusion: SBC urges the FCC to allow Price Cap Carriers to utilize GAAP Based Depreciation Lives.

May 18, 1999

Attachment 1

Comparison of FCC Prescribed Depreciation Ranges for ILECs with Competitors Economic Lives (in years)

Plant Category	FCC Prescribed Range for ILEC(1)	AT&T (2)	Electric Lightwave (2)	TCG (2)
Digital Switching	13-18	9.7	10	10
Digital Circuit	11-13	7.2	10	8
Fiber Optic Cable	25-30	20	20	20
Communications and Network plant (from 1998 AT&T Annual Report)		3-15		

Sources:

(1) FCC Prescribed range for digital switching from: FCC NPRM, July 22, 1998, CC Docket No. 98-137.

--FCC prescribed ranges for all other plant categories from FCC Third Report and Order, May 5, 1995, CC Docket No. 92-296.

(2) Depreciation rates for AT&T, ELI and TCG as of 1995 from: Testimony of Robert Harris On Behalf of U S West Communications Inc. Before the Arizona Corporation Commission, AT&T-U S WEST Interconnection Arbitration, Docket No. U2428-96-417, September 30, 1996, p. 38.